RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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December 26, 1990 **LETTER 1059**

THE FED FIGHTS: By their actions, the Fed is now obviously conceding that the nation is in recession. They lowered the discount rate to 6.5% after lowering bank reserves and ratcheting down the Fed Funds. The Fed is now at the stage where they are fighting the bear market "tooth and nail."

WHERE ARE WE?: Technicals: From its July high of 2999.75 to its October low of 2365.10, the **Dow** lost a total of **634.65** points. The rally from the October low saw the Dow climb to a December 19 peak of 2626.73. This represented a recovery of 261.63 points -- or **41%** of the ground lost during the July-October decline.

If that represented the best of the recovery, it was not a very impressive performance. Under **Dow's 50% Principle**, an impressive recovery would require the Dow to advance decisively above the halfway mark of the preceding decline. To accomplish that, the Dow would have had to push convincingly **above 2682.42.** So far, the Dow has failed to do that. If the Dow cannot better 2683, then the 50% Principle is telling us that in due time the Dow will approach, and then break to, new bear market lows (i.e., below 2365.10).

From its June high of 1212.77 to its October low of 821.93, the **D-J Transportation Average** lost a total of 390.84 points. The rally to the December 13 high of 917.17 saw the Transports recover 95.24 points or only **24%** of their June to October losses. So the rally on the part of the Transports was even less impressive than that of the Dow.

As far as the **Utility Average** is concerned, it appears that the Utilities topped out at 215.92 back on November 11. Since then the bellwether Utility Average has been in a mild downtrend.

Unless the Averages can do a lot better between now and January, I would say that the market is telling us that 1991 will be anything but a cheerful year. Failure (during subsequent rallies) to recover half of important losses has never been a good omen for the market.

Referring to the page 2 chart, you can see that my **Primary Trend Index** (PTI) remains in the bearish mode (i.e., below its 89-day moving average). On December 18, the PTI closed within two points of its bear market low -- then turned up again.

On the same chart you can see that the **Advance-Decline ratio** (A-D) has also been very sluggish during the recovery following its October low. In fact, the A-D, on the rally from its October low, recovered only **29%** of its June to October losses. As this is written, the A-D ratio is (incredibly) less than two points above its bear market lows -- meaning that the typical stock has done very little in the way of recovery since the October bear market lows.

The "Percentage of Undervalued Blue-Chip Stocks" (see statistics at top of page 1) has dropped (this really surprised me) to only 24%. At classic bear market bottoms, this percentage runs near or even above 80%.

Looking Ahead: The market is currently in its "thinking and probing" phase. Having rendered a Dow Theory bear market signal on January 25, and having sustained major losses during July to October, the market is now looking ahead. And it is trying to gauge the potential depth and duration of the gathering recession. Opinions are as many and as varied as there are gurus and analysts. The conventional wisdom seems to be, "Yes, we're now in a recession; no, it will not be a deep recession; and it will end sometime in mid-1991."

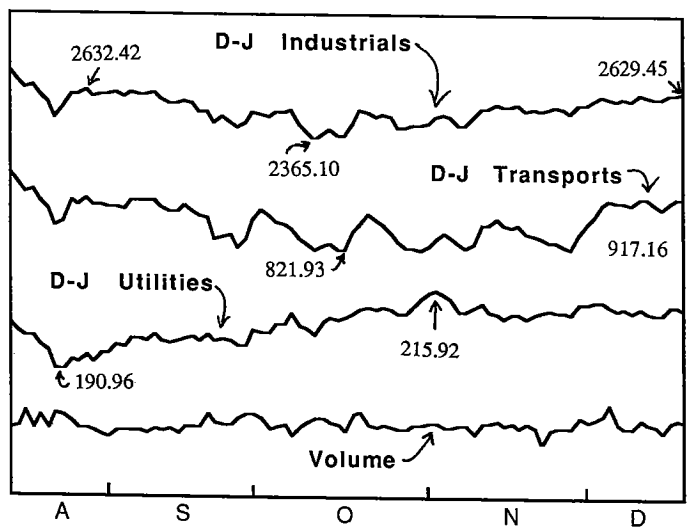
Dec. 14 DJIA 2593.81; PTI 3163; A-D Ratio -16.31
Dec. 20 DJIA 2629.45; PTI 3161; A-D Ratio -16.59
Dow Yield: 3.91%; Dow P/E: 13.7; DowPow: -759
Dow 200-day MA: 2689; Dow 30-day MA: 2574
Dow Book Value: 1276; PTI 89-day MA: 3192
Percentage of Undervalued Blue-chips: 24%

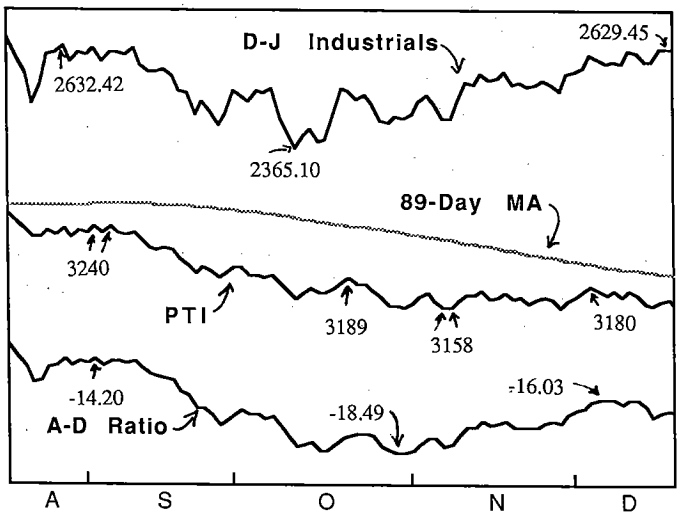
A few "perma-bulls" claim, "Although some areas of the nation are in recession, there are enough bright spots around to justify the claim that the US is not yet in recession and, in fact, a recession may very well be avoided."

Then there are the bears who state that we are in a recession, it's already a rough recession, and it will get rougher as time goes by. My economist friend, A. Gary Shilling, states that the optimists are looking at the wrong statistics. Says Gary, "What we're seeing is a balance-sheet-driven recession. The last time we had one of those was in the 1930s. Unfortunately, most analysts and economists don't see it because they are trained to look at income statements, not balance sheets. They don't see the kinds of things that suggest a recession."

Gary Shilling's view is (perhaps coincidentally) shared by a brilliant German economist with whom I trade publications. The European perspective is always interesting, and I include here a few paragraphs from the latest report by Dr. Kurt Richenbacher (*Currencies and Credit Markets,* Mendelssohn Strasse 51, D-6000, Frankfurt 1, Germany).

"The unfolding US recession is not caused by tight money or tight bank reserves. The causes all spring from one and the same source: the prior unprecedented credit boom. Basically, two maladjustments together form the most potent combination of contractive forces impacting on the US economy since the Great Depression of the 1930s: a serious corrosion of the US economy's growth potential and an unprecedented buildup of non-productive debt.





"The forces that are presently depressing the economy -- budget deficits, trade deficits, over-consumption, under-savings, under-investment, over-indebtedness, and collapsing asset price inflation -- simply have no place in the customary business cycle models. Clinging to the navigational instrument of a 'typical cycle,' the majority -- including the government and the Fed -- take for granted that a monetary easing will promptly stimulate the economy back to vigor as always. This time it won't work.

"It's clear to anyone who's not blind to the massive economic and financial maladjustments that have accumulated during the past upswing that the US economy is entering its deepest and longest recession since the 1930s. It will last a period of years and has only just begun to gather momentum. But simply because the causes of this recession do not fit the standard of American business circle textbooks, very few people recognize the seriousness of the situation."

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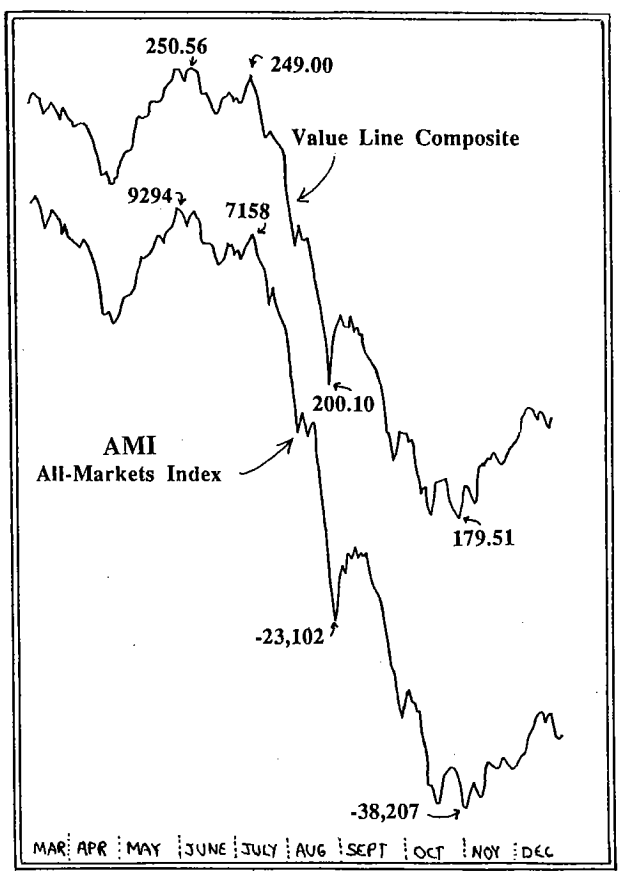

It's often instructive to step back and take a long, unemotional look at events. This process gives us much-needed perspective. Here's a partial listing, a short history of the early unwinding of the great American debt-boom of the 1980s. It's an unwinding, by the way, that is still very much in force. (1) Cave-in of the Farm Credit System. (2) Default of massive bank loans to Latin America. (3) Collapse of the energy sector of the nation and the folding of many Southwest banks. (4) The 1987 stock market crash, and the beginning of the depression on Wall Street. (5) Bear market in the dollar. (6) Relentless rise of deficits in all sectors of the nation -- federal, state, city, corporate, consumer. (7) Chronic deficits in the US trade balance, despite 50% drop in the dollar. (8) Collapse of the S&L industry and the FSLIC. (9) Crash of the junk bonds, and the court trials of the "junketeers." (10) Shakiness of the big money center banks, and the run-down of the FDIC funds. (11) Bear market smashes in virtually all foreign stock markets. (12) Cut-back in consumer spending during 1990, and the gathering "consumer gloom." (13) Slump in US auto sales. (14) Deflation in home and commercial real estate prices. (15) The Fed's belated panic -- the reversal of its tight money policy. The Fed gives up on inflation, turns to fighting recession.

So again, I come back to the question of "How deep will the recession be, and how long will it last?" One thing is clear -- the consensus thinking is that we'll have a mild to medium recession lasting into the middle of 1991, and from there on, the economy will pick up and by the end of '91 the recession will be just a memory.

In fact, this clip from the December 12 *USA Today* says it all.

> **PURCHASERS GLOOMY: The U.S. economy will slide into a recession in January but emerge from the downturn by the second half of 1991, say purchasing executives at 300 of the nation's manufacturers. The National Association of Purchasing Management's semi-annual economic forecast was released Tuesday. Purchasers are hoping that modest growth in exports will help lift the economy out of its downturn.**

At this point, many analysts are saying that the market has already discounted the worst that can be seen ahead (i.e., a recession lasting to mid-1991). Therefore, they opine, the rally from the October lows represents the market's discounting of better times starting in mid to late-1991.

Again, here is what I think. I believe we are in the early part of what I call "the great unwinding," the unwinding of the leveraging and debt of the past two decades. As far as the stock market is concerned (and I've said this repeatedly), this is going to be an extended bear market period, a painful period, a period filled with deceptive market rallies and mini-bull and bear movements -- and it's going to be a very costly one for investors.

There will be many periods when investors will be tempted to jump back into the market. There will be periods when the investor will want to load up on stocks, bonds, specific stock groups. My guess is that 90% of those who will try to "beat the bear" will end up as losers.

Already, I see that many of my friends, cohorts and fellow "experts" have switched to the bull camp. On all sides we hear that "the bear market could be over." On TV this morning, I heard a well-known analyst state, "The decline is already more than a year old. At its October low, the Dow lost 21% of its value while the broader indices lost up to 36% of their value. At the October lows, the stock market had already discounted the worst of this recession. Now's the time to buy. A new bull market is underway."

I wish I could agree, but I can't. The Dow is now yielding less than 4%, and it's selling at a lofty 2.26 times book value. At the same time the S&P 500 Composite is selling at a fat 26.8 times dividends. The publications I read are talking more about what to buy and the coming bull market than about the bear market we're in. So the truth is -- I haven't seen anything yet that even remotely resembles a major bear market bottom. This bear market is fated to be a marathon, not a sprint.

For my newer or younger subscribers, the following is worth knowing and remembering -- bear markets are much more difficult to live through than bull markets. The reason for this has a lot to do with TIME (and most investors tend to be very impatient). Time is the investors' best friend during a long bull market. In a bull market time means rising underlying values. Time means collecting and compounding dividends and stock extras. Time means irregularly higher stock prices. Time in a bull market will bail you out of most of your misjudgments and mistakes.

In a bear market the opposite it true. In a bear market time is an investor's worst enemy. Time means eroding underlying values. Time means irregularly lower stock prices. Time means compounding mistakes and errors. Time means declining or omitted dividends. Time means deteriorating business conditions and lower corporate earnings. Time means salary cuts and jobs lost.

THE MEASURE: In Letter 1057, I introduced AMI, my "All Markets Index" based on breadth on all three exchanges (NYSE, AMEX, NASDAQ). AMI is pictured again on page 2. Both AMI and the broad Value Line Composite Index can be used as a proxy for the typical investor's portfolio, and here we have a good picture of what's happened in this bear market so far. It's hardly a heartening view. It's a picture of substantial losses followed by an upside correction that so far has not been particularly impressive.

Note: Aside from the mess in the Persian Gulf, the current feature story in this bear market concerns the plight of the banks. The US has never faced a recession with the banking system in such disarray. The banks' problems are seemingly endless: Third World country write-offs, collapse of the junk bonds, defaults on LBO loans, indirect pressure from the S&L fiasco, the low level of funds in the FDIC, the deflation in real estate prices and defaults in commercial and residential real estate. Current estimate is that as many as 1000 banks could be on the edge of insolvency.

On December 17, FDIC Chairman Seidman stated that the FDIC will probably lose $4 billion this year and probably $5 billion next year, leaving it with only $4 billion to cover $2 trillion of deposits. Seidman proposed a one-time charge of 1% of bank assets which would raise about $25 billion. The problem is that this charge would eat up 25% of the banking industry's profits and 10% of its equity capital. But the big question of course is this -- how will the economy be next year and the year after? Said Seidman, "Predictions for two or three years ahead can really only be educated guesses. In three years, will we be in a booming economy, stagflation or a deep recession?" The banking industry wishes it knew.

INVESTMENT POSITION: The bear stays in the box. You know, the best thing (maybe it's the only good thing) about growing older is that you gain experience -- and hopefully, a bit of wisdom. Oh yeah, there is one other thing -- a lot of old people tend to get more honest. Why more honest? Well, you're nearer to your judgment day, and God isn't particularly fond of liars and hypocrites.

Anyway, I've had some experience with primary bear markets, and I've noticed that people who trade around a lot in bear markets, people who believe they can "beat the bear" -- those people usually end up with thin wallets and patches on their blue jeans.

The point I want to make is this -- if you have any greedy traits, a bear market offers you a great way to check those tendencies. Consider this: in a bull market you want to make money. A bull market means that you've got all the power of the primary trend behind you. A bull market is a time to start a new business, to buy a big house, to speculate in real estate, to load up on your favorite stocks, to beat inflation.

But in a primary bear market it's different. In a bear market you want to hang on to what you made in the bull market. In a bear market you try your darnedest to avoid losses. Yes, there will be losses. You'll lose money on the value of your home or you'll lose money in the stocks you own (of course, you shouldn't own any), or you'll lose money in your business (or maybe your business will just shrink a bit). And even if all else is working out fine, you'll lose money in the dollars you hold because the dollar has been heading toward the cellar.

You see, it's not an easy world we live in, but it's the only world we've got so we have to learn to function in it -- to survive in it. And if there's one thing I've learned in this business, it's that from an investment standpoint, we must position ourselves with the great tidal force, the primary trend of the market.

Unfortunately, the primary trend is now down. It's bearish. That's why I put the picture of the bear in this box -- to remind even those people who don't believe in the written word that it's "protect yourself time." It's the time of the bear.

What to do? I recommend protecting yourself with cash, and by cash I mean money market accounts (preferably in government T-bills), I mean T-bills, T-notes, and I also mean cash in the form of foreign currencies such as the Deutsche mark and the Swiss franc. I advocate owning some gold -- up to maybe 5% to 10% of your liquid assets.

Should you sell your home? No, unless you hate it or unless you don't mind the bargain procedure of renting. Your home is your place of rest, your refuge, the roof over your head. You've got to have some pleasures in life, and to me a home is one of them. I don't care if the value of my house drops in half, I'm sitting tight, I like it here. I guess it's a lot like living in California -- this state is an absolute taxpayer's nightmare, but I love it here. Frankly, there's no other reason to stay in the Golden State. If you don't love it, my advice is, "Get out." Tax-wise, it's cheaper to live almost any place else except New York City and maybe Sweden.

All kidding aside, remember that we are in a bear market, and you're going to need all the judgment, all the intelligence, and all the PATIENCE you can muster.

I write these Letters partly as a sort of hand-holder. People know that they come out every two weeks, and thus they can "hold my hand" (via mail or FAX) 26 times a year. If you haven't got patience, here's your chance to develop it. My mentor, Robert Rhea (the great Dow Theorist of the 1930s), used to say that "a bear market is a fine time to take a vacation." Rhea knew what he was talking about. Maybe I'll even take a week or two off in the spring (I've got to arrange my vacations around my wife, Faye, who just became an officer of the court, better known as a lawyer).

NOTES & QUOTES: The right wing of the Republican party has "had it" with Mr. Bush. They feel that Bush has betrayed the whole "Reagan Revolution" concept, and that Bush's switch on taxes was the the absolute last straw. In fact, so disgusted are Republican conservatives that many are actively talking about a rival Republican candidate for 1992.

A powerhouse of the conservative Republican sector is Pat Buchanan. In a recent column, Buchanan spelled out what he thinks is wrong and why. I happen to agree with most of what Buchanan says, and I thought this column was important enough to include here in its entirety (page 4).

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As the possibility of war looms closer, questions and problems are being raised. Here are a few: (1) Some military experts believe that it could be a very tough SIX MONTH war (not exactly what most Americans had in mind). (2) The "nightmare scenarios" keep coming up. Here they are: Saddam pulls out of all but the oil fields and the two islands. Would the US go to war at that point? Or,

Saddam stalls, but promises to get out of Kuwait but "at a later date." Would the US go to war at that point? (3) If the US does defeat Iraq, there is concern that the whole Arab world will take this almost as an "insult." (4) If the US defeats Iraq, what do you do with, and who will support, 150,000 Iraqi war prisoners? And who will pay for the rebuilding of Iraq and Kuwait? (5) The US is getting stuck for the huge war bill. So far, Japan has contributed $374 million, 40,000 Sony Walkmans and a few Toyotas. Germany has contributed a mere $330 million after offering only $800 million. The Saudis originally promised $3 to $5 billion but so far have sent only $987 million in cash and goods, equal to 6.5 days worth of their windfall profits.

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America's two largest industries are housing and autos. Housing is divided up among hundreds of large and small companies, and consequently there aren't any two or three companies that we can watch in terms of their being THE bellwethers of this industry.

Autos (at least US autos) are different. Three US auto companies dominate the auto industry: GM, Ford, Chrysler. What's happening in autos? First GM: on revenues of $128 billion (estimated) in 1990, GM will lose money. GM's annual $3 dividends may hold, but I wouldn't bet on it. Ford, on revenues of $98 billion (est.) in 1990, will see last year's $8.22 a share earnings drop to around $2.80 this year. Ford will probably cut its $3 dividend. Chrysler, with $33.3 billion (est.) revenues in 1990 may make around a dime a share. Chrysler claims it will not cut its dividend. Call me dubious.

Auto stocks and auto dividends are widely watched as a barometer of the whole economy. But mull this over: in 1972, the average length of a car loan was 35 months. By the end of 1988, the average length had increased to 56 months or almost five years. In 1980, the total of car loans outstanding was $111 billion. At the end of September 1990, car loans outstanding had zoomed to $285 billion, accounting for 40% of all consumer installment debt. So as of today, the US consumer is up to his eyeballs in cars and car debt . . . On December 12, the stocks of both GM and Ford both hit new 52-week lows.

* *

Even the gambling industry is being hurt in this recession. Atlantic City, which usually attracts only "here for the day" customers, is being hit hard, and all eyes are on Donald Trump and his crumbling Atlantic City empire. Las Vegas is also having its troubles. The problem in Vegas is oversupply of rooms plus stingy banks. The $615 million (3100-room) Mirage has recently opened for business followed by the enormous (3900-room) Excalibur, the world's largest casino. Together they have added 7,000 rooms to the 69,000 rooms that are already in Vegas. Some hotels are now offering rooms for $22 to $60 a night. And the food -- Vegas is a foodie's delight with bargain-priced "all you can eat" cafeterias as far as the eyes can see. How Vegas will weather the recession remains to be seen. Competition is fierce.

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Do you have a son who wants to play pro football or basketball? According to a Louis Harris survey, 43% of all black high school athletes believe they will become pro players. And 59% of all high school football and basketball players think they will get a college scholarship. Fact: Only one in 100 high school athletes will get a scholarship. And only one in 10,000 high school athletes will make the pros -- the pros (basketball and football) together take only 198 new players each year. Fact: only one out of three pro football players has a college degree, only one out of five pro basketball players has a college degree.

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I love odd, unusual and informative facts. Here are a few. During World War II, the Japanese cracked every US secret code but one. The code they couldn't crack was a code used by the Marines based on the Navajo Indian language . . . Last year 200 US women over the age of 44 had babies. This year one US woman over 50 (incredible) had a baby . . . In 1965, only

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Patrick J. Buchanan

If war comes to the gulf, America and Great Britain, victorious allies in World War II, will again carry the bloody burden of battle. Germany and Japan, defeated in World War II, will have made but a modest contribution: no warplanes, no warships, no troops. Yet, it is their oil, first and foremost, we are protecting.

So, it has gone through the Cold War. America and Britain, the defenders, annually spent 6 percent and 5 percent of GNP on defense. Germany and Japan, the defended, spent 3 percent and 1 percent.

Today, Britain is in recession, and America is headed there. But the German economy set a 14-year record in the third quarter, soaring at 5.5 percent. And Japan is enjoying a boom. Have the defeated powers of World War II learned some lessons that the victorious powers have not yet mastered? So it would seem.

Long ago, Germany and Japan gave up the old dreams of empires amassed by armies and fleets and set out to win the hegemony of their respective continents through productivity, investment and trade. Their success has been stunning.

Germany is now the dominant power in a 12-nation European Community that is an economic equal of the United States; Japan is dominant economic power in Asia, and a global rival and ferocious competitor to Uncle Sam.

Tokyo and Berlin seem to be sending a message to Mr. Bush's Washington: If you wish to be policeman of the New World Order, be our guest; we will its industrialists, merchants and bankers.

Just as Americans between 1865 and 1915 captured industrial and financial pre-eminence from Great Britain, so, Germans and Japanese are today taking it away from us.

As their currencies strengthen, ours grows weaker. Since the Plaza Agreement of 1985, the dollar has lost 47 percent of its value, with 15 percent lost this year alone. With the dollar cheapening every year, 60 percent of Japan's offshore portfolio investment now goes into Europe.

During his tour of South America, Mr. Bush visited Argentina and Brazil, two nations whose disastrous decline was brought on by devaluations and debt. Their present situation may bear no small resemblance to our own future condition.

As Chris Whalen writes in *Barron's*: "Interest payments on the $3.2 trillion in (U.S.) federal debt are growing twice as fast as the economy. At well over $300 billion, debt service next year will be the largest single component of the federal budget.

"Perennial budget deficits of $250 billion to $300 billion, added to the cost of the thrift-bank bailout ($100 billion per year) and the Persian Gulf adventure ($50 billion to $100 billion annually) mean that the national debt each year is growing by at least $500 billion . . . this suggests that publicly held Treasury paper could climb from the current 40 percent of GNP to nearly 100 percent by the turn of the century, a level previously reached only during World War II."

The willingness of foreigners to finance this vast borrowing is eroding, as the value of the dollars they earn continues to decline.

"This country's debt binge will stop," Whalen writes, "not at the urging of the public, Congress or a compliant central bank, but only when its creditors overseas demand it. Today, we borrow, pay for oil and buy the goods and services needed to fuel American industry with dollars; tomorrow, we may be asked to pay in yen, marks or commodities. It is not impossible that at some point in the nineties, Washington will be confronted with an IMF austerity program like the one imposed on Great Britain in the seventies."

Thanks to their foolish lending to the Third World, America's big banks lost world leadership in the 1980s to Japan's banks. With their real estate loans now turning as sour as their Latin loans, America's big banks are in even bigger trouble. Again, Whalen:

"(F)oreign investors are fast abandoning many of the big New York banks. No longer willing to risk deposits in FDIC-insured institutions, offshore money is flowing into solid regional banks and T-bills, or out of dollars entirely . . . in view of the nation's parlous financial state, emergency loans from the central bank may be all that stands between America and financial chaos in the 1990s."

Goldman, Sachs' Robert Hormats agrees: What makes the coming recession so dangerous is the anemic condition of the nation's banks.

Yet, in Washington, there seems little awareness of America's serious condition. Indeed, there is big talk of America now being the world's only Superpower, of the U.S. launching a new global crusade for democracy.

With what? The cupboard is bare. The only place America can get the money to maintain its military establishment, and continue expanding government-to-government aid through the IMF and World Bank, is by borrowing, by putting future generations of Americans even deeper in debt than they already are.

The old vocabulary is obsolete, the old thinking irrelevant. The day when America could play Atlas, and hold up the world — militarily, politically and financially — is over.

Chicago Tribune

6% of US Jews married non-Jews. In 1989, 49% of Jews married non-Jews. US Jews may be becoming an endangered species . . . The US' national banks' net income for the third quarter was $1.56 billion, down 40% from the second quarter. But these same banks wrote off $13.59 billion in bad loans during the first three quarters. Can you believe it, over $13 billion in rotten loans! The incompetence and stupidity of these so-called "bankers" is mind-blowing . . . Japan is preparing a program which will slow its military expenses to only 1% of its GNP . . . Japan now pays only 40% of the cost of retaining US troops in Japan (why the US needs troops in Japan is totally beyond me).

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I wrote an article on the short interest and the short interest ratio for *Barron's* back in 1959. I followed the short interest for years. But about five years ago I gave up on this study. Today it's meaningless for prediction purposes. The fact is that the short interest has been rising for the past decade. In fact it was at a record high just before the 1987 crash! What's happened is that institutions now use shorting in all sorts of exotic ways to hedge their investments and to hedge their bets. So forget the short interest as a gauge of investors' or traders' pessimism.

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You older readers (circa World War II) remember Tokyo Rose, who used to broadcast propaganda messages to the GIs. Well, Iraq has one now, and they call her Baghdad Betty. Recently, BB had the boys and gals in hysterics with this one: "Why are you men here in Saudi Arabia, waiting to die on the desert? At home your girl friends are sleeping with movie stars like Tom Selleck, Tom Cruise and Bart Simpson."

* *

My friend Martin Weiss (*Holt Advisory, Money & Markets,* Box 2923, West Palm Beach, FL 33402) states that Greenspan's loosening credit is a huge mistake, based on a mis-diagnosis of what's going on. We're not in a credit crunch, as Greenspan claims. Says Weiss, we're suffering from a "'money panic'. In a traditional credit crunch, businesses are so anxious to expand that they are willing to borrow at almost any cost, figuring the inflation and growing revenues will cover it easily. MONEY IS AVAILABLE -- provided you are willing to pay the price. In a money panic businesses are not bullish. How could they be? They're going broke! Bankers and investors are so scared of lending that they effectively closed down the credit markets. Even if they had the money they wouldn't lend it -- except to the very strongest borrowers. Money isn't available at any price." And that's the way Martin sees it. I don't disagree.

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I just received the "International" and the "European" chart books from David Fuller's *Chart Analysis Ltd.* out of London. I wish all my subscribers could run through these chart books covering hundreds of individual stocks from all nations. The remarkable thing is the damage that has been done. Stock after stock has been hit and hit hard, and I'm talking about stocks on ALL the exchanges from Japan to Norway, from Spain to Taiwan. In fact, as I look at these stocks I wonder why the world isn't in worse shape than it appears to be now -- or are these hundreds of collapsed stocks providing us with a picture of things to come?

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Personal: I just bought a dozen Frank Sinatra CD's. You know, the guy is just good. My wife's kid sister, Lynn (she works for me, she's 25, and she's very much a part of the rock and heavy metal generation) has (surprisingly) been converted. Now she's taken to playing Frankie while doing the daily charts. And by the way, those old songs (particularly Cole Porter) are great, unbeatable.

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I used to write a lot about San Diego, and actually, many of my subscribers moved out here. But when San Diego (the city) started filling up, fellow San Diegan's told me, "Russell, shut up, just keep it to yourself." Well, the fact is that San Diego is far from filled up. Last Sunday I hauled my Harley out and met with two other bike-riding friends. One was commodity trader Mike Susac, the other was Joe Sinclair, member of the Sinclair Oil family. So the three Harleys, with much noise, headed east on route 94. Within an hour we were in the middle of nowhere, on the gorgeous California high desert. Talk about space, talk about beauty -- purple-blue mountains, bone-dry desert, scrub pine, 75 degrees temperature, and mile after endless mile of open country.

Ahead the Laguna mountains. We roar up and through the winding mountain roads, past the Mexican town of Tecate (two miles to the south of us), past strange little isolated houses, and again out onto the broad desert. At the tiny "town" of Boulevard (altitude 3800 feet) we stop at a Mexican restaurant for burritos and coffee (watching my cholesterol, I just order orange juice).

I note that the people out here on the desert look different. Bearded men, blue jeans, rough hands, weather-beaten faces --the women pretty, clear complexions, soft-eyed, friendly, almost always smiling. We stop to talk to a gnarled old lady who is sitting in her 1940 Ford. She lives out here alone, been out here for 25 years (her husband is buried on the desert, a mile from her house). Joe asks, "Aren't you lonely?" She laughs, "Hell no, I've got a radio, TV, and few friends. And I like the quiet of the desert. Besides, I'm a rock collector."

We leave the restaurant, and we're back on our bikes. Now we're on old highway 80 and heading into the town of Pine Valley, where we gas up and pick up another Harley rider (he's down here from LA -- "Just wandering around, taking in the scenery"). From Pine Valley we head back to San Diego. It's 3 PM, and the temperature is dropping into the 60s. As we near San Diego the freeway begins to fill up with cars, and the four of us ride in staggered close formation (it's safer that way). The four Harleys are making a thunderous racket, and kids, noses pressed against the car windows, wave to us. We're flying -- my helmet develops a low whistle. By 4 PM we're back in La Jolla.

I've been out here since 1961, and after almost 30 years I finally feel kind of like a Californian. But I still have the transplanted Easterner's wonder about the West. Strange -- in my dreams, however, I'm invariably back in New York City. I don't know why I'm always in NYC in my dreams. I think it's because I loved the old New York, the great city of my youth, my "mother city." My unconscious may still be in NYC, but my heart's in Southern California. I wouldn't leave here for anything. To me, there's nothing in the world that compares with this amazing land of ocean, deserts and mountains. And space -- you could spread the whole population of the US over San Diego County alone and there'd be miles of room left over.

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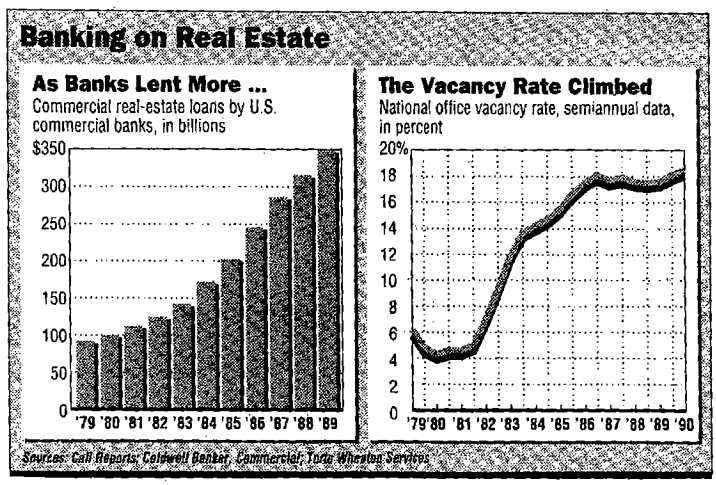
On the real estate front, the banks are having their troubles. The regulators want the banks to value their real estate to actual market value. At this concept, the banks with $350 billion worth of commercial real estate have been going into shock. Traditionally, the banks have been able to ride out their big problems by valuing their real estate optimistically (on the basis that every recession would be mild and short-lived). Since the '30s the banks have never had to ride out a long, deflationary recession/depression. Even now, if the banks had to "mark-to-market" on their real estate, many would be broke. Nevertheless, the examiners and



regulators are pushing for either realistic valuations or realistic loss reserves.

This chart from the Dec. 13 *Wall Street Journal* tells the story. It's not a pretty one, and it is far from ended.

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Speaking of real estate, I hear many people talking about the "distressed bargains" that now abound. My old friend Eliot Janeway (*Janeway Guideline,* 15 E. 80 St., NYC 10021) was writing about markets when most of us were kicking the slats out of our cradles. Here's Eliot's warning: "The press is loaded with reports of distress sales of ill-timed and ill-fated real estate projects . . . Offerings are piling up. Bids are not following, but temptation is on the rise . . . Action Line: Cheers for the idea, scallions for the timing, and disaster for suckers (who buy) any time soon. Take the rise of speculative interest as a warning of how far off the bottom is, and not just measured by the calendar."

* *

KKR (Kohlberg, Kravis, Roberts) was one of the heros of the "inflated '80s." Their junk bond prowess was capped by the massive RJR-Nabisco affair. But now comes word that a few of their programs are not working out. Two of the KKR partnerships (DK Associates and Whitehall Associates) show losses, according to their accountants, of over $350 million. And when you think about it, that's a lot of money.

* *

The Expert Pick: Last year Dan Dorfman (*USA Today*) asked 12 experts to pick their favorite stocks for 1990. Their performances are shown below. Each expert's estimate as to how his pick would do is shown in the Est. Gain column. How the picks actually did is shown in the last column. You think you can beat the bear? Be my guest.

How last year's pickers fared

Gary Helms of money-management firm Criterion Group trounced the competition by picking IBM during a slump last December.

Picker	Recommendation	Est. gain 12/89-12/90	Actual performance[1]
Gary Helms	IBM	+26%	+20.2%
S&P 500			-5.9%
J. McAllister	Amex Inc.	+54%	-6.0%
P. Weingarten	Woolworth	+22%	-8.1%
Eugene Sit	Amer. Int. Group	+20%	-11.3%
Irwin Jacobs	First Bank Sys.	+56%	-12.5%
Donald Trump	AMR Corp.	none[2]	-17.3%
Ron Baron	Golden Nugget	+58%	-23.3%
Steve Kroll	AT&T	+23%	-34.5%
Jane Gilday	Diasonics	+81%	-38.7%
Macao Sidar	First Chicago	+44%	-45.4%
Robert Raiff	Kellwood	+58%	-52.3%
Alan Lanz	Medtronic	+100%	-94.4%

1 - price change, 12/14/89 through 12/12/90. 2 - Trump wouldn't give a target price.
Source: USA TODAY research

NEXT MAILING: January 9

CLOSED-END FUNDS: It was back in 1946 when I bought my first closed-end fund. It was Tri-Continental, largest of the closed-end funds, and it still is (assets over $1.5 billion). I've always liked the closed-end funds. They are not well known by the public, are seldom bought by the institutions, and tend to sell at a discount from net assets.

Back in the 1940s and '50s there were very few of these funds, maybe a dozen. But during the late-1980s a slew of them came out. The public bought them eagerly, and the funds promptly sold off -- almost all to below assets. Why below assets? For one thing, unlike mutual funds they are not advertised and they are not pushed by salesmen. Therefore, the public generally is not familiar with them. Furthermore, these funds don't tend to be glamorous, and by that I mean they don't move up or down very rapidly.

But the better closed-end funds do offer an excellent way to buy the market (in most cases) below asset value. They also provide an excellent way to dollar-average over the years. Many of these funds pay both dividends and capital gains.

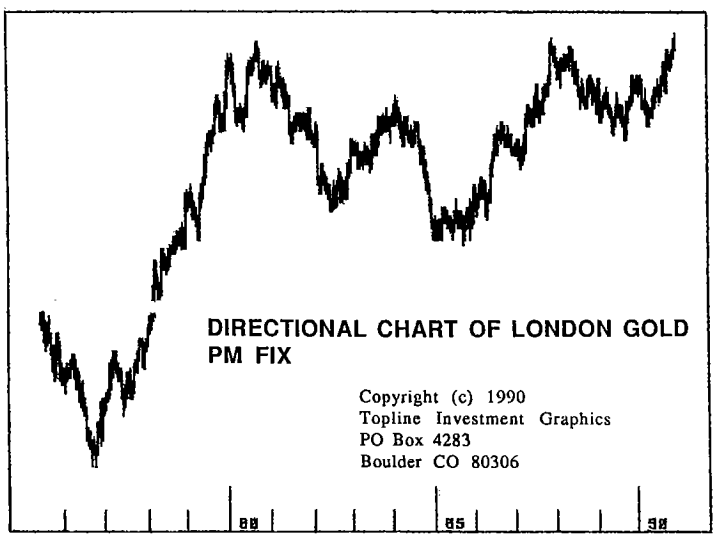
There are all kinds of closed-end funds available today, the majority listed on the NYSE. There are foreign closed-end funds (New Germany, Spain, France, etc.), there are basically stock funds (Salomon Bros, General American, Gabelli, Tri-Continental, etc.), there are government bond funds, municipal bond funds, foreign (global) government bond funds, and so-called "opportunity funds."

Barron's lists most of the funds showing discount from net assets. The newspapers list the funds showing yields. S&P (yellow) tear sheets describe the funds. You should familiarize yourself with the closed-end funds. In my opinion, they represent one of the best and most conservative areas for the long-term investor.

GOLD: On December 19, the February gold contract closed at 388, up 9.60 for the day. In doing so, it broke above a four-month declining trendline. This is a technical plus. A much bigger plus would be a rise in the February contract to above 395 (395 was the November peak). Bettering 395, gold would be in line to attack the September peak at 418.

My friend, John Carder, sent me this fascinating "directional chart" of gold, a chart going back to 1975. The graph on this chart moves up or down an equal distance each day -- based on whether gold closes up or down for the day. As you know, I keep a directional chart of the Dow, but this is the first time I've seen a directional chart of gold.

The gold directional chart recently broke out to new highs. What this is telling us is that during 1990 the great majority of gold closings have been to the upside. This is a subtle study and one that almost no one follows. A rising trend in a directional chart is basically bullish. As a rule, price action tends to follow the trend of a directional index. For this reason, the 1990 rising trend in the directional index for gold must be construed as bullish. That the great majority of gold closes are on the upside implies accumulation . If so, we should shortly start to see gold moving up in price.



LATE NOTES: The PTI performance has been remarkable during the rally from the October low. Study these statistics: The Dow low on October 11 (this is where the rally started) was 2365.10. On the same day, the PTI was **3167.** On December 20, the Dow was 2629.45 for a rise of 264.35 points. But on December 20, the PTI was **3163,** 4 points LOWER THAN WHEN THE RALLY STARTED. What does that mean? Well, for one thing it represents one of the most divergent actions I've ever seen on the part of the PTI. It also means that the rally has seen a great deal of RESISTANCE on the part of many sectors of the market. I've seen resistance on many previous occasions, but off hand I can't remember seeing a rally of this duration in which the PTI actually declined.

The resignation of Gorbachev's closest ally, Shevardnadze, has thrown the free world into a stomach-churning tizzy. Will the hard-liners take over the Soviets? Will favorite, free market favorite, Boris Yeltsin, take over? Will Gorbachev turn hardliner or will he exit the scene? The world wonders -- and sweats it out.